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What You Don't Know Can Hurt You

Understanding the Importance of 'Realizable' Value When Doing a Sale or Succession of Your Business

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What you don't know can hurt you

Now that you're getting serious about how you want your business life to end you want to be sure that your lifetime of work will produce financial independence. But you don't know how businesses are valued in the real world of buyers and sellers. You probably expected your long-term advisers to give you that advice. But it is one of the sad aspects of business life that the knowledge of how businesses are valued in the real market of buyers and sellers is poorly understood…even by most of the professionals that owners depend upon for guidance.

For most business owners, the single, most important financial asset they have is their business. If retirement is going to be funded by that business (whether via succession or selling), it is critical to know what that value is. The most common first step owners take is getting a business valuation.

Realizable Value Versus Taxable Value

One of the critical errors owners make is they get a standard business valuation. They do this in the belief the information they get from the standard valuation will be close to what they can achieve from a sale. Unfortunately this is not the case. Here's why.

The valuation industry focuses on serving applications that involve the IRS and state taxing agencies such as estate planning, gifting, charitable contributions, etc. This is where the largest demand for valuations comes from. Therefore they use the body of information on valuation that represents what occurs if you have to defend yourself in front of taxing agency.

Taxable value is basis of value that the Internal Revenue Service (or other taxing agency) feels your business is worth. Their interest is getting as much tax revenue as possible from any transaction such as a gift or a death as possible. So naturally the methods they've approved for valuations are going to lead to outcomes that suit their goals.

By contrast, buyers of businesses are looking to pay as little as possible and get the best return on investment possible. Buyers want to be sure that the money they put at risk in such investments isn't lost. Unlike the taxing agency, a buyer is much more critical of factors that might inhibit business success. So the world of real buyers uses much different criteria than a taxing entity to establish the value they will pay. That value is the **realizable value** a genuine transaction might achieve.

Marketability vs. Value

There is a factor that may be even more important than business value in determining whether you can achieve financial independence. This is *Marketability*.

Marketability is the sum of all the factors that make a business likely to be purchased in the real world of buyers and sellers. If you take nothing else from this paper, I would like for you to understand that *a business can have value in the eyes of the law when in fact that value can't be realized when you bring the business to market!*

An Example of How Realizable Value and Marketability Vary from Taxable Value

Here is a simple example. Assume we have an architectural design firm with two principles, one with 75% and the other with 25%. They have buy-sell agreement. It is a very profitable firm but the real value comes from the design genius of the senior partner. The senior partner dies suddenly without having done any tax planning. The IRS determines that the business has a significant value based on its historical earnings. His heirs now have a taxable event. They want the junior partner to buy the 75% interest at the value established by the IRS. He demurs. He can't afford it and *he knows that the value has substantially diminished because of the loss of the senior partner!* The heirs then say they want to sell the practice. *But the practice is unmarketable because it has lost its primary asset, the senior partner!* The business has value in the eyes of one group, the taxation officials, but that value can't be achieved.

This is only the most obvious of the factors that can affect realizable value and marketability. It is critical to know your realizable value and whether your business is marketable and if not why.

You Can Change Your Outcome – If You Know What and How

I have purposely been writing in very stark terms. This is because I have had to deal with so many clients when it has been too late to really change their circumstances w*hen if they had only begun earlier we could have found the problems affecting value and marketability and overcome them.*

Rarely are the factors that reduce value and marketability irresolvable. In addition there are tools that can build financial independence that do not require a business sale. The changes businesses need to make in order to achieve desired retirement wealth outcomes are not rocket science – but they do require time…*and willingness to embrace change.*

Knowledge is Power – Get the Knowledge of Your True Marketability and Value!

The Will Your Business Pay for Your Retirement© assessment is specifically designed to give you exactly what you need to know. It will give you a real market assessment of your value and marketability *and it will tell you why, how to change it, and how to work with those changes to get the financial independence you desire*